

Message Text

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ACTION EB-04

INFO OCT-01 SS-04 EUR-03 NSC-04 CEA-01 FRB-03 INR-01
CIAE-00 ISO-00 SSO-00 INRE-00 /021 W
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O R 131214Z JUL 78
FM AMEMBASSY PARIS
TO DEPARTMENT OF TREASURY IMMEDIATE
INFO SECSTATE WASHDC 4738
AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY ROME
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 01 OF 02 PARIS 22190

USEEC

LIMDIS GREENBACK

E. O. 11652: GDS
TAGS: EFIN
SUBJECT: EUROPEAN MONETARY SYSTEM (EMS)

REF: (A) BRUSSELS 13677, (B) PARIS 22115,
(C) LONDON 11012, (D) PARIS 21942

1. TREASURY ATTACHE PAID A CALL ON JACQUES WALL IN HIS
NEW POSITION AS DEPUTY SECRETARY GENERAL AT THE ELYSEE.
WHILE HIS DISCRIPTION OF THE MOTIVATION FOR THE EUROPEAN
MONETARY SYSTEM (EMS) WAS NOT VERY DIFFERENT FROM THE
GISCARD INTERVIEW IN LE MONDE APPEARING THE SAME DAY
(SEE REF B), HE DID ADD A NUMBER OF INTERESTING POINTS
ON HOW THE SYSTEM WOULD FUNCTION AND HOW THE FRENCH
THOUGHT THEY WOULD MANAGE THEIR RELATIONSHIP WITHOUT
GOING THROUGH THE HUMILIATING EXERCISE OF WITHDRAWING
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AS THEY DID FROM THE SNAKE TWICE BEFORE.

2. WAHL STATED THAT THEIR ANALYSIS BEGAN WITH THE
OBSERVATION THAT THE COMMUNITY HAD NOT GROWN AS
RAPIDLY AS THE OTHER TWO UNITS OF THE WESTERN
INDUSTRIALIZED WORLD, THE U.S. AND JAPAN. THE CAUSE,
IN HIS VIEW, WAS THE GREATER OPENNESS OF THE EC TO

WORLD TRADE. IT HAD ABOUT THE SAME DEGREE OF TARIFF PROTECTION AS THE UNITED STATES BUT CONSIDERABLY LESS THAN JAPAN. BUT MORE IMPORTANT, INTERNATIONAL TRADE WAS A FAR GREATER PERCENTAGE OF GNP. EXPORTS PLUS IMPORTS AS A PERCENTAGE OF GNP WAS ABOUT 48 PERCENT FOR THE COMMUNITY, 22 PERCENT FOR JAPAN, AND 16 PERCENT FOR THE UNITED STATES. HALF OF THAT TRADE WAS INTRA-COMMUNITY. THEREFORE, THE EMS WOULD HELP TO STABILIZE ONE QUARTER OF THE COMMUNITY'S ECONOMIC ACTIVITY BY INSULATING IT FROM ABRUPT AND SUBSTANTIAL EXCHANGE RATE CHANGES. THIS SHOULD STIMULATE GROWTH IN EUROPE AND INDIRECTLY ELSEWHERE.

3. SECONDLY, MONETARY INTEGRATION WAS A MEANS OF FURTHERING THE OBJECTIVE OF EUROPEAN INTEGRATION. IN THIS MATTER, "YOU MUST GO FORWARD ALL THE TIME OR ELSE SUFFER RETROGRESSION."

4. AS TO THE WORKINGS OF THE EMS, WAHL AGREED TO ITS CHARACTERIZATION, AFTER HIS DESCRIPTION, AS A COMBINATION IMF AND EPU. THE CENTER OF THE SYSTEM WAS THE ECU AS IT IS NOW. EACH MEMBER CURRENCY WOULD BE FIXED IN RELATION TO IT IN THE SAME WAY CURRENCIES HAD ONCE BEEN RELATED TO THE DOLLAR IN THE IMF. SINCE THE BASKET WAS COMPOSED OF BOTH WEAK AND STRONG CURRENCIES, IT PROVIDED AN ELEMENT OF FLEXIBILITY THAT DID NOT

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EXIST IN THE SNAKE. THIS WOULD WORK IN TWO WAYS. DIVERGENT PRICE LEVEL TRENDS LEADING TO A PERCEPTION OF STRONG AND WEAK CURRENCIES, FOR EXAMPLE, WOULD NOT NECESSARILY FORCE THE WEAKER CURRENCIES OUT OF THE ARRANGEMENT. IT WOULD DEPEND ON HOW FAR AND FOR HOW LONG THEY DIVERGED FROM THE AVERAGE MEMBER COUNTRY PRICE TREND. SECOND, A SPECULATIVE MOVEMENT OF CAPITAL AWAY FROM THE DOLLAR TOWARD THE DEUTSCHE MARK WOULD BE REFLECTED IN THE ECU ONLY IN PROPORTION TO THE MARK'S WEIGHT IN THE ECU AND, THEREFORE, REQUIRING THAT THE FRANC MOVE ONLY A FIFTH OR QUARTER OF THE DISTANCE IN THAT DIRECTION.

5. FRANCE COULD REMAIN IN THIS SYSTEM MORE EASILY THAN IN THE SNAKE. WHILE ITS RATE OF INFLATION WAS STILL RELATIVELY HIGH, COMPARED TO MANY COMMUNITY COUNTRIES, HE DID NOT EXPECT THAT IT WOULD NECESSARILY REMAIN SO IN THE FUTURE. BUT IF THEY WERE NOT SUCCESSFUL IN REDUCING THE RATE OF PRICE INCREASE ENOUGH, THEY WOULD, IN GOOD BRETTON WOODS FASHION, ADJUST THE EXCHANGE

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C O N F I D E N T I A L SECTION 02 OF 02 PARIS 22190

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RATE, NOT WITHDRAW FROM THE SYSTEM.

6. IN RELATION TO CURRENCIES OUTSIDE THE EMS, BOTH THE
COST IN RESERVE ASSETS AND EXCHANGE WOULD BE SHARED BY
ALL THE MEMBERS. (ANOTHER SOURCE SPECULATED THAT WHEN
THE SYSTEM BECAME ACCEPTED BY THE MARKET CAPITAL MOVE-
MENTS WOULD NO LONGER GO SIMPLY TO STRONG CURRENCIES
WITHIN THE EMS BUT TO THOSE TO WHERE THE INTEREST
RETURN WAS HIGHEST.)

7. LONGER TERM CREDITS IN THE EUROPEAN FUND WILL BE
EXTENDED IN TERMS VERY SIMILAR TO THE IMF TRANCHES--
I.E., THE LARGER THE AMOUNTS, THE MORE STRINGENT
THE CONDITIONS.

8. WAHL STRESSED THAT THERE WERE REALLY NO INNOVATIONS
HERE "AND THAT IT WAS CLASSIC" IN ITS CONCEPTION.
THEY WERE REALLY AIMING AT CREATING A EUROPEAN VERSION
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OF THE IMF WITH THE ECU IN PLACE OF THE SDR OR DOLLAR
AND THE SAME MODE OF OPERATION WITHIN THE COMMUNITY.

9. THESE MATTERS ARE REGARDED AS HIGHLY SENSITIVE
WITHIN THE FRENCH GOVERNMENT BECAUSE GISCARD IS
PERSONALLY INVOLVED. TECHNICAL WORK IS STILL
INCOMPLETE, AND NO ONE ELSE SEEMS PREPARED TO TALK
BEFORE THE EC MONETARY COMMITTEE NEXT WEEK OR POSSIBLY
THE MINISTERIAL MEETING ON JULY 24.

COMMENT:

WAHL AT DIFFERENT TIMES IN THE CONVERSATION STRESSED
FRENCH CONTINUITY OF THOUGHT IN EXCHANGE POLICY. THE
EMS AT FIRST BLUSH WOULD SUGGEST THAT THE FRENCH ARE
PREPARED TO ACCEPT FLOATING WITH THE DOLLAR AND THE
YEN BUT NOT WITHIN THE COMMUNITY. SECOND, THEY WISH
TO DIFFUSE THE IMPACT OF INWARD CAPITAL MOVEMENTS
OVER THE COMMUNITY AS A WHOLE BY COORDINATED INTER-
VENTION. THIRD, THEY SEE THE ECU BASKET, NOT WIDER
MARGINS OR TEMPORARY FLOATS, AS THE ELEMENT OF
FLEXIBILITY IN THE SYSTEM. THIS WOULD SUGGEST THAT
THEY WOULD LIKE TO SEE THE U.K. AND ITALY AND ANY OTHER
WEAK CURRENCY IN THE SCHEME TO MAKE THEIR TASK LESS
DIFFICULT.

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